

MEMORANDUM

TO: Mary Ann Borgeson, Chair, Douglas County Commissioner
Clare Duda, Vice-Chair, Douglas County Commissioner
Mike Boyle, Douglas County commissioner
Marc Kraft, Douglas County commissioner
PJ Morgan, Douglas County Commissioner
Chris Rodgers, Douglas County Commissioner
Pam Tusa, Douglas County Commissioner

CC: Thomas Cavanaugh, Douglas County Clerk/Comptroller
Kathleen Hall, Chief Deputy Douglas County Clerk/Comptroller
Jerry Prazan, Finance Administrator Douglas County Clerk/Comptroller
T. Paul Tomoser, Audit Committee Chair
Jack Armitage
Ron Bucher
Joni J. Davis
Kathleen Kelley, Chief Administrative Officer
Joe Lorenz, Director of Budget and Finance
Patrick Bloomingdale, Deputy County Administrator
Eric Carlson, Purchasing Agent
Fred Weber

FROM: Mike Dwornicki, Internal Audit Director

DATE: July 7, 2011

SUBJECT: Physical Inventory Audit

Background

As part of the fiscal year audit plan, Douglas County Internal Audit performs internal control testing for the Douglas County external audit firm, Hayes and Associates, LLC. The external auditor uses the test data provided by Internal Audit to formulate a professional opinion about the County's year-end financial statements. Below are the details related to tests of the controls in place for conducting the year-end physical inventories at the County Warehouse and Garage.

Objectives

The objectives of the audit were to determine that controls were in place to ensure

- The completeness and accuracy of inventory records

- Accurate treatment of inventory movement during the physical count
- Slow or obsolete items are properly identified and priced at net realizable value

Scope and Methodology

The audit included a review of the written procedures used to conduct the inventory as well as observation of the completion of the counts at the County Garage and the Warehouse. The audit at the Garage was conducted 6/13/2011 and the Warehouse 6/17/2011. The inventory observation included steps to ensure:

- Proper segregation of duties were maintained by the count teams
- Complete counting of all items and locations
- Proper treatment of any receipts or issuances of stock
- Proper identification and treatment of slow-moving or obsolete inventory

Additionally, fifty judgmentally selected inventory items (twenty-five from the warehouse and twenty-five from the garage) were test-counted. The test-counts were traced to the teams' counts and the final inventory listings. The adjustments made for the Warehouse items were traced to the general ledger entry. The Garage adjustment is made at year-end.

Inventory Adjustment Information

The net adjustment to inventory totaled \$71. This amount consisted of positive and negative offsetting adjustments of \$3483 for the Warehouse and (\$3412) for the Garage. The bulk of the Garage adjustment resulted from a (\$1220) adjustment of unleaded fuel.

A review of fuel inventory conducted in February 2011 noted that prior audits of fuel indicated that there were differences between the two systems used to track fuel inventory. The results in this audit showed that these differences were insignificant. There was virtually no difference between the systems for unleaded fuel from February to the date of the Garage inventory. The difference for diesel fuel had increased by seventeen gallons. For the same time period, the differences in the tank monitor readings and the tracking systems for diesel grew by eight gallons and by one hundred gallons for unleaded. A difference between the tank monitoring and inventory systems is expected due to environmental conditions including temperature and air pressure as well as inexact measurements from fuel delivery systems. The unleaded adjustment for the year was a reduction of 377 gallons. This was .19 % of the total gallons pumped from 7/1/2010 through 6/13/2011. The diesel adjustment was a reduction of 45 gallons or .03% of the total gallons pumped.

Findings

Identification of Slow-Moving or Obsolete Inventory

Criteria: Inventory procedures should be in place to ensure that slow-moving or obsolete inventory items are properly identified and priced at net realizable value. Additionally, the inventory system should provide aging reports to aid in identifying slow-moving and obsolete

inventory. This is particularly important for items where physical observation may not provide a clear indicator of age.

Condition: Inventory policy and procedures did not appropriately define what constitutes slow-moving and obsolete inventory or what to do with it once it is identified. An aging of the Warehouse inventory was not available.

Effect: Although through observation of the counting it did not appear that obsolete inventory was included in the counts, it is possible that obsolete or slow-moving inventory may be included in the records due to the fact that an aging of the items could not be obtained. The inability to identify slow-moving or obsolete inventory could result in an overstatement of assets in the year-end financial statements. It could also result in inefficient use of space within the Warehouse.

Cause: Written procedures for conducting the year-end inventories did not include steps to address slow-moving and obsolete inventory. Oracle did not have the functionality to produce an aged inventory for the Warehouse.

Recommendation: Draft inventory procedures that define slow-moving and obsolete inventory for the County. The procedures should provide for identification of these types of items throughout the fiscal year. Develop an aged inventory report for the Warehouse that can be used throughout the year to help identify slow-moving and obsolete inventory.

Management Response: The Purchasing Agent has met with the purchasing staff to begin the process of updating inventory procedures to incorporate steps to define slow-moving and obsolete inventory for the County. Further, the Purchasing Agent has engaged with DOT.Comm to start the development of an Oracle-based aged inventory report for the Warehouse, which can be used to help identify slow-moving and obsolete inventory.

Audit Standards

Internal Audit conducted this audit in accordance with generally accepted government auditing standards. Those standards require that the audit is planned and performed to obtain sufficient, appropriate evidence to provide a reasonable basis for the findings and conclusions based on the audit objectives. Internal Audit believes that the evidence obtained provides a reasonable basis for its findings and conclusions based on the audit objectives.

Internal Audit has reviewed this information with the Douglas Count Purchasing Agent. Internal Audit appreciates the excellent cooperation provided by management and staff. If you have any questions or wish to discuss the information presented in this report, please contact Mike Dwornicki at (402) 444-4327.